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Feature Article - Measuring International Portfolio Investment

INTRODUCTION

Changes in international capital markets during the 1980s made it increasingly difficult for compilers of balance of payments statistics to measure portfolio capital flows. In 1992 an International Monetary Fund report found that, at the world wide level, recorded portfolio liabilities far outweighed portfolio assets - by as much as \$US400 billion even in 1988 and apparently increasing since then. The IMF promoted the idea of an internationally Coordinated Portfolio Investment Survey (CPIS) to help resolve these discrepancies and about 30 countries participated in it.

This article outlines the main features of the CPIS and presents estimates of overseas equity and long term debt securities held by Australian residents as at 31 December 1997.

BACKGROUND

Changes in international capital markets during the 1980s opened new possibilities for raising capital, investing, and hedging risk; and a wide range of new participants emerged in these markets. The increasing importance of borrowing and lending in the form of securities led to a surge in the issuance of bonds in international markets. Banks and securities firms expanded their operations into foreign markets after the deregulation of security markets in many countries. New channels opened through which securities could be bought and sold in foreign markets, and cross-border securities trading increased sharply.

Institutional investors such as pension funds, insurance companies and investment trusts diversified heavily into foreign securities, as restrictions on investment activities were lifted in many countries, notably Japan. Increasingly, large investors dealt in foreign markets or directly with foreign issuers of securities. The trend to diversified portfolios also increased considerably the demand by private individuals for foreign securities.

Faced with these changes, balance of payments compilers throughout the world have found it increasingly difficult to measure portfolio capital flows. At the global level, there were large imbalances in the components of portfolio investment throughout much of the 1980s and 1990s, partly because the activities of new participants were not sufficiently covered by the statistical data sources used. The extent of these global imbalances was first highlighted by the report, in 1992, of the International Monetary Fund's (the IMF's) Working Party on the Measurement of International Capital Flows. This study found that recorded portfolio liabilities far outweighed portfolio assets at the worldwide level. Theoretically, external aggregate assets should equal external aggregate liabilities if perfectly measured. However, external assets were understated by as much as \$US400 billion even in 1988, and judging from available transactions data collated by the IMF, the understatement appears to have further increased in the 1990s.

Concerned by such discrepancies, the IMF Committee on Balance of Payments Statistics decided in 1993 to promote the idea of a CPIS. While some countries, such as Australia, already conducted surveys to measure portfolio investment, there had not been a coordinated international approach.

The proposed CPIS was to be coordinated both in terms of timing and design, and to spread best statistical practice among countries. Some 30 countries agreed to participate in the CPIS which was conducted at the reference date of end-December 1997.

This article outlines the main features of the CPIS, presents the results obtained from the Australian collection, and indicates where future action will occur.

PURPOSE OF THE COORDINATED PORTFOLIO INVESTMENT SURVEY

The purpose of the CPIS has been to improve estimates of portfolio investment in the form of equity and long term debt. Specifically, the objectives were:

- To collect comprehensive information, with geographical detail, on the stock of cross-border equities and long term bonds and notes held by Australian residents for use in the compilation or improvement of international investment position (IIP) statistics on portfolio investment capital. The IIP statistics, in turn, can provide information to check the coverage of recorded estimates of portfolio investment capital flows, and of the associated investment income transactions recorded in the balance of payments.
- To exchange, so far as confidentiality constraints permit, the bilateral statistics. When the results of the CPIS become available, the participating countries, with the assistance of the IMF's Statistics Department, plan to exchange these statistics among themselves and with other countries. By exchanging comparable statistics and aggregating them, participating countries should be able to improve their estimates of non-resident holdings of their portfolio investment liabilities as well as associated capital flows and investment income data. Information on the geographic distribution of non-resident creditors also becomes known.

CONCEPT OF PORTFOLIO INVESTMENT

The compilation and presentation of ABS international investment position statistics conform with the prevailing international statistical standard, namely the IMF's Balance of Payments Manual, Fifth Edition (BPM5). These statistics are classified in several ways with the primary classification based on type of investment. There are four broad categories - direct investment, portfolio investment, other investment and reserve assets.

Direct investment is a category of international investment that reflects the objective of an investor in one economy (the direct investor) obtaining a significant on-going interest in an enterprise resident in another economy (the direct investment enterprise). The significant on-going interest implies a degree of influence by the direct investor in the management of the direct investment enterprise. In BPM5, evidence of this significant interest is defined as ownership of 10 per cent or

more of the equity of a direct investment enterprise. Portfolio investment is cross-border investment in equity and debt securities (other than direct investment). Reserve assets are those financial instruments available to and controlled by the Reserve Bank of Australia for balance of payments management purposes, such as financing imbalances and managing exchange rates. Other investment is a residual group that comprises many different kinds of investments.

Within these categories further classification levels occur based upon factors relating to general analytical usefulness. For example for portfolio investment, the type of instrument is the primary classification (i.e. equity and debt securities). Corporate equities include company shares, investment fund units, and documents denoting ownership of equity (for example, American Depository Receipts). Debt securities are broken down into bonds and notes, money market instruments, and financial derivatives. Bonds include marketable bonds, debentures, and notes that have an original contractual maturity of more than one year. Long-term negotiable certificates of deposit are also treated as bonds.

The focus of the CPIS was on the equity securities and the long term debt securities (i.e. bonds and notes) classified to portfolio investment.

COORDINATED PORTFOLIO INVESTMENT SURVEY METHODOLOGY

To assist countries with limited experience in the collection of portfolio investment data, the IMF prepared a reference document, Coordinated Portfolio Investment Survey: Survey Guide, which was released in August 1996. The IMF noted that surveys could primarily target end-investors, custodians (that is, financial institutions that administer or manage non-resident securities on behalf of residents) or a combination of both. In addition, the IMF noted that data could be collected either on an aggregated or on a security-by-security basis. The former approach relies on the survey respondents to aggregate, allocate and value all of their international portfolio investment. By contrast, in the latter approach, respondents are asked for details of the quantity and other information about each security held, while data on the market value of each of these securities could be determined from a suitable commercial database which prices securities. Although the estimates obtained through either approach are conceptually the same, collecting data on a security-by-security basis has the potential of providing more information on, for instance, currency attribution, yields on securities, etc.

Since Australia already collects much of the relevant data required through the quarterly Survey of International Investment (SII) from end-investors on an aggregate basis, there was only limited additional information to obtain.

However, to improve the quality of the geographical detail of portfolio investment assets that were to be obtained from the December quarter 1997 SII, the existing sample survey was supplemented by additional resident enterprises that were known to have relevant portfolio investment activity. As a consequence, the totals for portfolio investment in foreign equity and long term debt securities obtained from the CPIS are slightly different from the corresponding estimates obtained from the regular quarterly survey, where a coverage estimate is made for the small contributors that are not included in that regular survey.

In addition, during the December quarter 1997 survey, respondents were urged to take particular care in determining the country attribution of securities investments and to identify the residence of the issuer rather than report the residence of the non-resident fund manager which has occurred in past reporting in the SII. As a result, the country data obtained are of a high quality and are more reliable than similar data from previous surveys.

CPIS data requirements are consistent with the SII in all aspects except for the treatment of securities lending and repurchase agreements. The SII treats securities exchanged under these agreements as having changed ownership while the CPIS does not. For this reason, three supplementary questions were added to the December quarter 1997 SII to separately identify the impact of securities lending and repurchase agreements as at the end of the quarter.

RESULTS OF THE SURVEY

The table on page 8 shows that, at 31 December 1997, the level of Australian portfolio investment abroad, as measured through the CPIS, stood at \$50,360 million for equity securities and \$11,413 million for long term debt securities. Australian residents' investment in foreign equity securities was dominated by investment of \$21,893 million (or 43%) in US equities. Other significant holdings of equity securities were in the UK, \$7,783 million (15%); countries in the European Union (apart from the UK), \$8,296 million (16%); and Japan, \$5,386 million (11%). Australia's investment abroad in the form of long term debt securities was also heavily focused in the USA (\$5,627 million or 49%), while Germany (\$1,192 million) and the UK (\$1,135 million) each accounted for a further 10%.

Due to the reasons outlined above, the data shown for total equity securities and total long term debt securities in the table on page 8, differ slightly from the corresponding data shown in Balance of Payments and International Investment Position, Australia, June Quarter 1998 (cat. no. 5302.0) (table 30, page 58).

FUTURE DIRECTION

The IMF will act as a central clearing house for the compilation of aggregate data from those countries which have undertaken the CPIS and will supplement it with additional data in respect of central bank holdings. The IMF will provide the resultant data to participating countries as well as non-participating countries. Confidentiality constraints will be observed. By exchanging comparable statistics, countries should be able to improve their estimates of non-resident holdings of their portfolio investment liabilities as well as associated capital flows and investment income data.

This international project is recognised as an important initial step in being able to understand and identify gaps in statistical collections and methodologies for measuring portfolio investment. It is likely that the IMF will consider recommending that an international joint project such as this will be repeated in the future.

FURTHER INFORMATION

For further information on the Coordinated Portfolio Investment Survey, contact Director of International Investment Section.

LEVELS OF AUSTRALIAN PORTFOLIO INVESTMENT ABROAD, by country - 31 December 1997

| Country of issuer | Market value of equity securities \$m | Market value of long term debt securities \$m | Country of issuer | Market value of equity securities \$m | Market value of long term debt securities \$m |
|------------------------|--|--|-------------------|--|--|
| Argentina | 67 | .. | Philippines | 68 | .. |
| Austria | 61 | 14 | Poland | np | .. |
| Belgium | 109 | np | Portugal | 79 | .. |
| Bermuda | np | .. | Romania | np | .. |
| Botswana | np | .. | Russia Federation | np | .. |
| Brazil | 244 | .. | Saudi Arabia. | np | .. |
| British Virgin Islands | np | .. | Singapore | 295 | np |
| Canada | 610 | 247 | Slovak Republic | np | .. |
| Cayman Islands | .. | np | South Africa | 82 | np |
| Chile | 6 | .. | Spain | 463 | 140 |

| | | | | | |
|-----------------------------|-------|-------|-----------------------------------|---------------|---------------|
| China, People's Republic of | 67 | np | Sri Lanka | np | .. |
| Colombia | np | .. | Sweden | np | 185 |
| Croatia | np | .. | Switzerland | np | np |
| Czech Republic | np | .. | Syria | np | .. |
| Denmark | 130 | 130 | Taiwan | 103 | .. |
| Egypt | np | .. | Tanzania | np | .. |
| Fiji | np | np | Thailand | 57 | .. |
| Finland | 182 | np | Tonga | np | .. |
| France | 2,071 | 237 | Turkey | 73 | .. |
| Germany | 2,033 | 1,192 | United Kingdom | 7,783 | 1,135 |
| Greece | 33 | .. | United States of America | 21,893 | 5,627 |
| Hong Kong | 1,222 | 159 | Venezuela | np | .. |
| Hungary | 37 | np | Viet Nam | np | .. |
| India | 76 | .. | Zimbabwe | np | .. |
| Indonesia | 102 | .. | Asia unspecified | 1 | .. |
| Ireland, Republic of | 67 | np | Europe unspecified | 312 | 3 |
| Israel | 16 | .. | Unallocated | 742 | 484 |
| Italy | 1,257 | 269 | Sum of confidentialised countries | 301 | 515 |
| Japan | 5,386 | 616 | | | |
| Jordan | np | .. | | | |
| Kazakhstan | np | .. | Total all countries | 50,360 | 11,413 |
| <hr/> | | | | | |
| Korea, Republic of | 103 | 163 | Country groups(a) | | |
| Luxembourg | np | np | APEC | (b)30,417 | 7,179 |
| Malaysia | 193 | np | ASEAN | (c)715 | np |
| Mexico | 182 | np | EU | (d)16,079 | 3,401 |
| Myanmar | np | .. | OECD | 46,402 | 10,394 |
| Netherlands | 1,121 | 52 | | | |
| New Caledonia | np | .. | | | |
| New Zealand | 130 | 245 | | | |
| Norway | 156 | .. | | | |
| Pakistan | 6 | .. | | | |
| Panama | np | .. | | | |
| Papua New Guinea | np | .. | | | |
| Peru | 40 | .. | | | |

(a) For details of country groups, see the Appendix in the 1996-97 edition of Balance of Payments and International Investment Position, Australia, (cat. no. 5363.0).

(b) Excludes Papua New Guinea, the contribution of which is not material to the APEC total.

(c) Excludes Viet Nam.

(d) Excludes Luxembourg, the contribution of which is not material to the EU total.

n.p. not for publication but included in the sums of confidentialised countries and totals were applicable.

.. not applicable.

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